IN THE

Supreme Court of the United States

October Term, 1943

No. 492

THE EQUITABLE LIFE ASSURANCE SOCIETY OF THE UNITED STATES,

Petitioner,

vs.

GUY T. HELVERING, Commissioner of Internal Revenue,

Respondent.

PETITION FOR WRIT OF CERTIORARI AND BRIEF IN SUPPORT THEREOF

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PETITION FOR WRIT OF CERTIORARI

To the Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Your petitioner, The Equitable Life Assurance Society of the United States, respectfully submits its petition for a writ of certiorari to review the judgment of the United States Circuit Court of Appeals for the Second Circuit, modifying, and affirming as modified, a decision of the United States Board of Tax Appeals (now the Tax Court of the United States) concerning the petitioner's income taxes for 1933.

Jurisdiction of the Court.

This application is made pursuant to Section 1141 of the Internal Revenue Code (53 Stat. 164), and Section 240 of the Judicial Code, as amended (43 Stat. 938).

The judgment below was entered August 18, 1943 (R. 134).

Statute Involved.

The statute involved is the Revenue Act of 1932 which provides in part as follows (47 Stat. 223, 224 and 225):

"Sec. 201. Tax on Life Insurance Companies.

(a) Definition. When used in this title the term 'life insurance company' means an insurance company engaged in the business of issuing life insurance and annuity contracts (including contracts of combined life, health, and accident insurance), the reserve funds of which held for the fulfillment of such contracts comprise more than 50 per centum of its total reserve funds.

(b) • • •

Sec. 202. Gross Income of Life Insurance Companies.

(a) In the case of a life insurance company the term 'gross income' means the gross amount of income received during the taxable year from interest, dividends, and rents.

(b) • • •

Sec. 203. Net Income of Life Insurance Companies.

(a) General Rule.—In the case of a life insurance company the term 'net income' means the gross income less—

• • • • • • • •

(2) Reserve Funds.—An amount equal to 4 per centum of the mean of the reserve funds required by law and held at the beginning and end of the taxable year, except that in the case of any such reserve fund which is computed at a lower interest assumption rate, the rate of 3¾ per centum shall be substituted for 4 per centum. Life insurance companies issuing policies cover-

ing life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation, shall be allowed, in addition to the above, a deduction of 3¾ per centum of the mean of such reserve funds (not required by law) held at the beginning and end of the taxable year, as the Commissioner finds to be necessary for the protection of the holders of such policies only;

* * * * * * * *

(8) Interest.—All interest paid or accrued within the taxable year on its indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this title."

Questions Presented.

1. Is the petitioner's reserve called "Present value of amounts not yet due on supplementary contracts not involving life contingencies" a reserve fund for which a deduction is provided by Section 203 (a) (2) of the Revenue Act of 1932?

2. If the petitioner is not entitled to the reserve deduction claimed, is it entitled to a deduction under Section 203 (a) (8) of the Revenue Act of 1932 in the amount of the "excess interest dividends" paid within the taxable year, pursuant to the provisions of its supplementary contracts not involving life contingencies as well as the deductions allowed below for guaranteed interest paid on such contracts?

Facts.

The petitioner is a mutual life insurance company organized and existing under and by virtue of the laws of the State of New York, having its principal office and place

of business in the City of New York and being engaged in the business of issuing and selling life insurance and annuity contracts. At all times more than 50% of its total reserve funds have been held for fulfillment of its life insurance and annuity contracts (R. 105).

During and prior to the calendar year 1933 the petitioner issued life insurance policies which gave to the insured, and in some cases to the beneficiary, the right to require the petitioner to hold the face amount of the policy after the date upon which it would otherwise be payable, supplement this amount with annual increments of interest, and pay out the increased amount in installments or otherwise over varying periods of time (R. 109, 118A). The contracts which evidence the exercise of such options under these provisions are known as "Supplementary Contracts." When the payments to be made under these contracts are not affected by a life contingency (contracts arising from the exercise of Options 1, 2 and 4) they are known as supplementary contracts not involving life contingencies and are so referred to herein (R. 109).

It has been stipulated:

> "To provide for the payment of life policies which had matured and were payable during 1933 and subsequent years under these 'Supplementary Contracts not Involving Life Contingencies' the petitioner carried on its books a liability (which the petitioner contends is a reserve liability) named 'Present Value of Amounts not yet Due on Supplementary Contracts not Involving Life Contingencies,' in the following respective amounts at the beginning and end of the calendar year: $34,806,201 and $42,326,682" (R. 109).

This liability carried on petitioner's books was the amount which, if supplemented with annual interest increments, would exactly equal petitioner's obligations under the Supplementary Contracts Not Involving Life Con-

tingencies, in respect of amounts not yet due at the time of valuation (R. 110, 120). There is no issue in this case as to the fact that the petitioner was required by state statute and regulations to maintain this reserve in the amounts stated, it being stipulated that:

> "For the purpose of providing for these obligations, the taxpayer was required to accumulate and maintain this liability by the statutes of the states in which it was then doing business and by the rulings of state officials made pursuant to authority conferred upon them by such statutes, and as so required the petitioner at all times held admitted assets sufficient to provide for this and all other reserves and/or liabilities" (R. 110).

The supplementary contracts provided for interest at the guaranteed rate of 3% per annum. However, they also provided that, in any year when the petitioner declares that funds held thereunder shall receive interest in excess of 3% per annum, the payment shall be increased for that year by an "excess interest dividend" as determined and apportioned by the Society (R. 109, 118A).

The petitioner contends that its liability or reserve designated "Present Value of Amounts Not Yet due on Supplementary Contracts not Involving Life Contingencies" is one of "the reserve funds required by law," with respect to which Section 203 (a) (2) of the Revenue Act of 1932 provides for a deduction.

Solely as an alternative claim, petitioner contends that, if it is not entitled to the reserve deduction claimed, then it is entitled to a deduction under Section 203 (a) (8) for the interest paid on its supplementary contracts, whether the supplementary contract arises from an option exercised by the insured or by the beneficiary, including amounts termed "excess interest dividends" as well as amounts paid as "guaranteed interest."

The court below, affirming the Board, held that the reserve is not one of the "reserve funds required by law" for which a deduction is provided under Section 203 (a) (2), and stated in its opinion (R. 131) that it felt compelled to reach this decision because of the views expressed by Mr. Justice BUTLER in *Helvering* v. *Illinois Life Insurance Co.*, 299 U. S. 88, and *Helvering* v. *Inter-Mountain Life Insurance Co.*, 294 U. S. 686, which the court below interpreted as a holding on the part of this Court that deductions are provided only for reserves which are held for contingent obligations.

On brief before the Board the Commissioner conceded that the petitioner is entitled to the alternative deduction, under Section 203 (a) (8), in the amount of guaranteed interest paid on contracts arising from the exercise of Option 1 by either the insured or the beneficiary (R. 81).

The court below affirmed the decision of the Board (a) in allowing such alternative deduction; (b) in allowing the alternative deduction in the amount of guaranteed interest paid on contracts arising from the beneficiary's election of Options 2 and 4; and (c) in disallowing the alternative deduction in the amount of the "excess interest dividends" paid. The court held it error on the part of the Board to disallow the alternative deduction in the amount of guaranteed interest paid on contracts which arose from the insured's election of Options 2 and 4.

Reasons Relied on for the Allowance of the Writ.

1. The Circuit Court of Appeals for the Second Circuit has decided an important question of Federal Law in conflict with *Helvering* v. *R. J. Reynolds Tobacco Co.*, 306 U. S. 110; and *Helvering* v. *Oregon Mutual Life Insurance Co.*, 311 U. S. 267.

In *Helvering* v. *R. J. Reynolds Tobacco Co.*, 306 U. S. 110, this Court held that the Commissioner could not amend his Regulations in 1934 and apply them retroactively so

as to require a taxpayer to include in taxable gross income for 1929 gains realized in buying and selling its own stock and bonds, where the Regulations in force from 1920 to 1934, inclusive, provided that such gains were not required to be included in taxable gross income, and the statute was reenacted without change over the period covered by the Regulations.

In *Helvering* v. *Oregon Mutual Life Insurance Co.*, 311 U. S. 267, this Court held that where administrative regulations promulgated under every Revenue Act from 1921 through 1932 recognized the right of life insurance companies to take deductions for disability reserves, and where the 1934 reenactment of Section 203 (a) (2) followed thirteen years of administrative regulations and practice under which substantially identical provisions had been so construed and applied that life insurance companies could and did obtain these deductions, the Commissioner could not make those reserves non-deductible by issuing Regulations to that effect in 1935 or by a retroactive amendment of his earlier Regulations.

In the instant case, under the identical statutory provision considered in *Helvering* v. *Oregon Mutual Life Ins. Co., supra,* the same Regulations there involved, in force from 1921 until 1935, expressly held the reserve here involved, called "Present value of amounts not yet due on supplementary contracts not involving life contingencies," to be one of the reserve funds for which a deduction is provided by the Revenue Acts (*Reg. 62, 65, and 69, Art. 681; Reg. 74 and 77, Art. 971.* See: Appendix); and life insurance companies were instructed by official Form 1120-L, prescribed by the Commissioner for their income tax returns, to take deductions for this reserve. Indeed, this reserve was the first life insurance reserve held to be a "reserve fund" within the meaning of the revenue acts: *Mutual Benefit Life Insurance Co.* v. *Herold* (1912), 198 Fed. 199, affirmed with a *per curiam* opinion which did not mention this issue (CCA-3, 1913) 201 Fed. 918, cert. den.

(1913) 231 U. S. 755, construing Act of 1909, Sec. 38 Second (36 Stat. 113). The Regulations in force under the 1913, 1916, 1917 and 1918 Acts all expressly held this reserve to be one of the "reserve funds" for which those Acts provided a deduction. *Reg. 33, Art. 147(d); Reg. 33 (Revised). Art. 240; Reg. 45, Art. 569.* (Set out in Appendix hereto.)

But on February 11, 1935, Regulations were promulgated asserting this reserve to be non-deductible under the 1934 Act, and on December 18, 1935, a Treasury Decision declared that this Regulation applied retroactively to the 1932 and earlier Acts.

In auditing the petitioner's income tax return for 1933, the respondent disallowed the reserve deduction involved herein on the ground that his amended regulation should be given full retroactive effect (R. 29). This is the same retroactive amendment which was held invalid in *Helvering* v. *Oregon Mutual Life Insurance Co.*, 311 U. S. 267, and the fundamental reasoning which required the holding in that case that disability reserves are "reserve funds required by law" requires a like holding as to the reserve involved herein.

In *Helvering* v. *Oregon Mutual Life Insurance Co., supra,* this Court held:

> "It seems clear that Congress intended to permit the deduction of reserves based on those policies that make a company a 'life insurance company' under the Act, which, by definition, includes policies of 'combined life, health, and accident insurance'."

By the same definition the Act also includes "annuity contracts" among those policies which make the petitioner a "life insurance company" *Revenue Act of 1932, Sec. 201 (a).* And by the respondent's own regulations and well established rulings the supplementary contracts herein involved constitute *annuity contracts* within the meaning of that term as used in the Revenue Acts: *Reg. 103, Sec. 19.22*

(b)(2)-2; Reg. 101, 94, 86, Art. 22(b)(2)-2; S. O. 160, II-2 C. B., Dec. 1924, p. 60; I. T. 2635, XI-2 C. B. Dec. 1932, p. 63. And see *Mertens on the Law of Federal Income Taxation* (Callaghan & Co., 1942) Vol. 8, Ch. 44, Sec. 44.34, where, with reference to this holding in the *Oregon Mutual* case, it is stated (at p. 156):

> "By the same reasoning, it seems that Congress also intended to provide a deduction for the reserve for supplementary contracts, for supplementary contracts, both involving and not involving life contingencies, constitute *annuity contracts* the issuance of which makes a company a 'life insurance company' by statutory definition.
>
> "It has been held consistently that payments received by the beneficiaries under supplementary contracts not involving life contingencies constitute *annuities* within the meaning of that term as used in the revenue acts; and this is in accord with the meaning of the term 'annuities' as long used and understood by the legal profession and by life insurance authorities."

2. The Circuit Court of Appeals for the Second Circuit has rendered a decision in conflict with decisions of other Circuit Courts of Appeals on the same questions.

The decision below is in direct conflict with *Mutual Benefit Life Insurance Co.* v. *Herold* (1912) 198 Fed. 199, at pp. 213 and 214, aff'd with a *per curiam* opinion which did not mention this issue (CCA-3, 1913) 201 Fed. 918, cert. den. (1913) 231 U. S. 755, which held that the reserve here involved is one of the reserve funds for which a deduction is provided. That case was decided under the Excise Tax Act of 1909 but it is well settled that the "reserve funds" for which that Act provided a deduction are the same reserve funds for which a deduction is provided by the later Acts including the Revenue Act of 1932. See: *Mertens on the Law of Federal Income Taxation* (Callaghan & Co., 1942) Vol. 8, p. 72.

In the opinion below (R. 133) the Circuit Court, itself, points out that its decision denying this petitioner the alternative deduction claimed for excess interest paid on these contracts is in conflict with the decision of the Circuit Court of Appeals for the Seventh Circuit in *Commissioner* v. *Lafayette Life Insurance Co.*, 67 F. (2d) 209.

On this same issue the decision below, as the court notes in its opinion (R. 132), is also in conflict with *Lederer* v. *Penn Mutual Life Insurance Co.* (CCA-3, 1919) 258 Fed. 81 at p. 92, affirmed on other issues (1920) 252 U. S. 523, which held that excess interest paid on these supplementary contracts (there called "Trust Certificates") constitutes "interest" and not dividends either in the commercial or insurance sense of that term.

There are other conflicts of which this petitioner cannot complain but which indicate that the matter should be settled by this Court. In allowing this petitioner a deduction for guaranteed interest paid under supplementary contracts which arose from options exercised by the insured, the decision below is in conflict with the decisions of the Circuit Court of Appeals for the Third Circuit in *Penn Mutual Life Insurance Co.* v. *Commissioner* (two cases) 92 F. (2d) 962 and 972, as noted in the opinion below (R. 132); and with the decision of the Circuit Court of Appeals for the Fifth Circuit in *Pan-American Life Insurance Co.* v. *Commissioner*, 111 F. (2d) 366, affirmed on other issues (1940) 311 U. S. 273.

3. The Circuit Court of Appeals for the Second Circuit has decided an important question of Federal Law which has not been but should be settled by this Court.

Supplementary contracts not involving life contingencies are annuity contracts which are provided for in practically every life insurance policy issued in this country, to effectuate what has been termed "the obvious purpose of life insurance," i. e., to afford protection to the beneficiary *for a period of years* subsequent to the death of

the insured: Dawson, *The Business of Life Insurance* (1905), p. 241; Huebner, *Life Insurance* (1st ed.), pp. 99 and 100; Magee, *Life Insurance* (1939), pp. 325 to 327, and 464.

Life insurance companies doing business in this country pay out nearly two hundred million dollars a year under these supplementary contracts which constitute the major part of their annuity business.[1]

A large number of life insurance companies have suits or claims for refund pending which involve, *in the alternative,* their rights to a deduction for this reserve and their rights to a deduction for guaranteed and excess interest paid under the supplementary contracts for which the reserve is held. Many of these suits and claims have been suspended pending the final outcome of the instant proceeding.

The decision below is not the final answer, for as to each of the issues, as shown above, it is in conflict with either the decisions of this Court or, there being no such decision, with the decisions of the Circuit Courts of Appeals for other Circuits which have passed on such issues.

Life insurance companies are seeking an authoritative answer to the following questions:

One. Which is the proper deduction for supplementary contracts, the reserve deduction under Section 203 (a) (2) or the deduction for interest paid on indebtedness under Section 203 (a) (8)?

Two. *If the latter is the proper deduction,* how shall it be computed?

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[1] *Spectator Compendium of Official Life Insurance Reports,* 1941, p. 136 A, where it is shown that payments made during 1940 by 305 life insurance companies under supplementary contracts totalled $213,400,837; and that all other annuity payments made that year by the same companies amounted to $142,284,323. While no split up is shown in the total amounts paid as between supplementary contracts involving life contingencies and supplementary contracts *not* involving life contingencies, the consideration received during the year for each of these types of contracts is shown, and indicates that 85% of the payments made under supplementary contracts were made under those which did *not* involve life contingencies.

The Commissioner's retroactive amendment of his Regulations has given rise to a number of cases involving these questions. But in each of the cases reaching the Circuit Courts of Appeals for other Circuits, the insurance company abandoned its claim to a reserve deduction in favor of the alternative but larger deduction for both guaranteed and excess interest paid:

Penn Mutual Life Insurance Co. v. *Commissioner* (CCA-3, 1937) 92 F. (2d) 962;
Penn Mutual Life Insurance Co. v. *Commissioner* (CCA-3, 1937) 92 F. (2d) 972;
Pan-American Life Insurance Co. v. *Commissioner* (CCA-5, 1940) 111 F. (2d) 366; affirmed on other issues (1940) 311 U. S. 273.

Accordingly, although various and conflicting decisions have been reached by the Board of Tax Appeals and by the Circuit Courts of Appeals for the Second, Third and Fifth Circuits, on the secondary question as to the proper basis for computing the alternative deduction for interest paid, the instant proceeding is the first case in which a Circuit Court of Appeals has passed upon the primary question as to whether the reserve deduction or the deduction for interest paid, is the proper deduction for supplementary contracts under the 1921 and subsequent Acts.

The court below, though not free from doubt (R. 132), felt compelled to deny the reserve deduction because of certain expressions in opinions rendered by this Court in two cases which had nothing to do with *insurance* reserves maintained for the protection of *insurance* beneficiaries: *Helvering* v. *Inter-Mountain Life Insurance Co.* (1935) 294 U. S. 686; and *Helvering* v. *Illinois Life Insurance Co.* (1936) 299 U. S. 88.

That the opinions rendered in these two cases need clarification was pointed out in the *1939 Supplement to Paul*

and Mertens on the Law of Federal Income Taxation, at pages 1793, 1795 and 1796, where it is stated:

> "The language in those opinions may be clarified if the Supreme Court is called upon to decide whether a life insurance company is entitled to a deduction for its reserve for supplementary contracts.
>
> • • • • • • • •
>
> "The *Inter-Mountain* and the *Continental Assurance Co.* cases can be distinguished on the ground that the funds there involved were of a type expressly excluded from the meaning of the phrase 'reserve funds required by law' by the Treasury Regulations. These two cases and the *Illinois Life* case can be distinguished upon the further ground that the funds there involved, unlike the reserve for supplementary contracts, were held for the profit of the policyholders rather than for the protection of the beneficiaries. In an earlier decision the Supreme Court held that Congress in the taxation of life insurance companies provided certain deductions where the element of protection was predominant but that it was not the intent of Congress to provide the same deductions in relation to profits payable to the policyholders. This distinction which has been noted and applied in cases dealing with reserve deductions, may account for the provisions in the Treasury Regulations which prior to 1935 held the reserve for supplementary contracts to be a 'reserve fund required by law' while excluding from the meaning of that phrase funds of the type involved in the *Inter-Mountain* case. This distinction may also be the real basis for the decisions in the *Illinois Life*, the *Inter-Mountain* and the *Continental Assurance Co.* cases, and, if this is so, these decisions do not bar a reserve deduction for the reserve for supplementary contracts which is maintained exclusively for the protection of the beneficiaries."

But for the decision below the questions involved herein would now seem to be settled by the decision of this Court

in *Helvering* v. *Oregon Mutual Life Insurance Co.*, 311 U. S. 267, for the fundamental reasoning in that case and the decision therein would seem to reaffirm the right of life insurance companies to a deduction for this reserve. See: the dissenting opinion of Board Members Black and Arundell, below (R. 89); and *Mertens on the Law of Federal Income Taxation* (Callaghan & Co., 1942) Vol. 8, at pp. 154 *et seq.* And see Note 46, p. 167 of that volume for a discussion of the difficulties in applying, as the court below has done, the deduction for interest paid on indebtedness under Section 203 (a) (8) of the Act instead of the reserve deduction under Section 203 (a) (2), to payments made under these supplementary contracts.

Prayer.

WHEREFORE, your petitioner respectfully prays that a Writ of Certiorari issue to the United States Circuit Court of Appeals for the Second Circuit commanding said court to certify and send to this Court for its review and determination on a day certain to be named therein, a full and complete transcript of the record and all proceedings in said case, and that said judgment of the United States Circuit Court of Appeals for the Second Circuit may be reversed by this Honorable Court; and that your petitioner may have such other and further relief in the premises as to this Honorable Court may seem just; and your petitioner will ever pray.

THE EQUITABLE LIFE ASSURANCE
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BRIEF IN SUPPORT OF PETITION

Opinions Below.

The opinion of the Circuit Court of Appeals below (R. 128) has not yet been officially reported.

The opinion and the dissenting opinion below (R. 63, 88) of the United States Board of Tax Appeals (now the Tax Court of the United States) are reported in 44 B. T. A. 293 and 312.

Jurisdiction.

The jurisdiction of this Court is set forth in the petition on page 1 above.

Questions Presented.

The questions presented are set forth in the petition on page 3 above.

The Statute and Regulations Involved.

The statute involved is set forth in the petition on pages 2 and 3 above. The Regulations involved are set out in the Appendix.

Facts.

A statement of the case is made in the petition beginning on page 3 above.

Specification of Errors to Be Urged.

1. The Circuit Court of Appeals for the Second Circuit erred in holding that the reserve called "Present value of amounts not yet due on supplementary contracts not involving life contingencies" is not a reserve fund for which a deduction is provided by Section 203(a)(2) of the Revenue Act of 1932 (47 Stat. 224).

2. The said court erred in holding that the excess interest dividends which the petitioner determined and paid during the year 1933 on its supplementary contracts not involving life contingencies, pursuant to the policy provisions under which those contracts arose, does not constitute interest paid on indebtedness within the meaning and intent of Section 203(a)(8) of the Revenue Act of 1932 (47 Stat. 225).

3. The said court erred in failing to hold upon the facts as found by the United States Board of Tax Appeals (now the Tax Court of the United States) that the petitioner is entitled in full to one or the other of the deductions, claimed in the alternative, under Section 203(a)(2) and Section 203(a)(8) of the Revenue Act of 1932 (47 Stat. 224 and 225).

ARGUMENT.

I.

The decision below is in direct conflict with *Helvering* v. *R. J. Reynolds Tobacco Co.*, 306 U. S. 110.

In *Helvering* v. *R. J. Reynolds Tobacco Co.*, 306 U. S. 110, this Court held that the Commissioner could not amend his Regulations in 1934 and apply them retroactively so as to require a taxpayer to include in taxable gross income for 1929 gains realized in buying and selling its own stock and bonds, where the Regulations in force from 1920 to 1934, inclusive, provided that such gains were not required to be included in taxable gross income, and the statute was reenacted without change over the period covered by the Regulations. In that case this Court stated (306 U. S. 110 at pp. 114 and 116):

> "The administrative construction embodied in the regulation has, since at least 1920, been uniform with respect to each of the revenue acts from that

of 1913 to that of 1932, as evidenced by Treasury rulings and regulations, and decisions of the Board of Tax Appeals. In the meantime successive revenue acts have reenacted, without alteration, the definition of gross income as it stood in the Acts of 1913, 1916, and 1918. Under the established rule Congress must be taken to have approved the administrative construction and thereby to have given it the force of law.

* * * * * * * *

"We hold that the respondent's tax liability for the year 1929 is to be determined in conformity to the regulation then in force.

* * * * * * * *

"Since the legislative approval of existing regulations by reenactment of the statutory provision to which they appertain gives such regulations the force of law, we think that Congress did not intend to authorize the Treasury to repeal the rule of law that existed during the period for which the tax is imposed."

In the instant case, under the Corporation Excise Tax Act of 1909, and under each succeeding revenue act, life insurance companies have been provided a deduction for "reserve funds". The Treasury Regulations as issued under every Revenue Act from 1913 to 1932, both included, expressly held that the reserve for supplementary contracts involved herein is one of the "reserve funds" for which deductions were provided by those Acts. *Reg. 33, Art. 147(d); Reg. 33 (revised), Art. 240; Reg. 45, and 45 (1920 ed.), Art. 569; Reg. 62, 65 and 69, Art. 681; Reg. 74 and 77, Art 971* (set out in Appendix).

The Revenue Acts of 1909, 1913, 1916, 1917 and 1918 provided a deduction for *all* insurance companies in the amount of:[2]

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[2] Sec. 38 Second, Act of 1909 (36 Stat. 113); Sec. IIG(b), Act of 1913 (38 Stat. 172, 174); Sec. 12(a) Second, Act of 1916 (39 Stat. 768); Tit. I, Sec. 4, Act of 1917 (40 Stat. 302); Sec. 234(a)(10), Act of 1918 (40 Stat. 1079). Note: In the 1918 Act the words "if any" were omitted and "within the year" was changed to "within the taxable year."

> "the net addition, if any, required by law to be made within the year to reserve funds"

The reserve involved herein was the first life insurance reserve held to be one of the reserve funds for which a deduction was provided by the quoted provision of those five earlier Acts. *Mutual Benefit Life Insurance Co.* v. *Herold* (1912), 198 Fed. 199 at pages 213 and 214, aff'd with a *per curiam* opinion which did not mention this issue (CCA-3, 1913), 201 Fed. 918, cert. den. (1913), 231 U. S. 755.

The 1918 reenactment of the quoted provision was made in the light of that decision and of *Regulations 33, Art. 147(d)*; and *33 (revised), Art. 240, supra.* Accordingly the Regulations issued under the 1918 Act expressly held (*Reg. 45, Art. 569*):

> "In the case of life insurance companies the net addition to the 'reinsurance reserve' and the '*reserve for supplementary contracts not involving life contingencies,*' and the net addition to any other reserve funds necessarily maintained for the purpose of liquidating policies at maturity, are legally deductible." (Italics supplied.)

Before enacting the new plan for taxing life insurance companies, subsequently embodied in the Revenue Act of 1932,[3] Congress, through its Ways and Means Committee, requested and received a digest of all United States Court decisions under the Internal Revenue Acts from 1909 to 1919 inclusive: *Notes on the Revenue Act of 1918 (Ways and Means Committee, 66th Cong., 1st Sess.) Part I, page 3.* Two of the four cases cited in this digest as dealing with life insurance reserve deductions, dealt with the reserve involved herein; and both of these cases are there cited to the Ways and Means Committee as holding this reserve

[3] This plan, embodied in sections 201, 202 and 203 of the 1932 Act (47 Stat. 223) was first enacted in 1921 as sections 242 to 245 of the 1921 Act (42 Stat. 261). See: *National Life Insurance Co.* v. *U. S.* (1928) 277 U. S. 508.

to be one of the reserve funds for which a deduction was provided by the 1918 and prior Acts.[4]

One of the reasons for enacting the 1921 plan was that the provisions of prior acts applicable to life insurance companies were "imperfect and productive of constant litigation." *House Report No. 350, 67th Cong. 1st Sess., page 14.* Unquestionably the litigation referred to included *Mutual Benefit Life Ins. Co.* v. *Herold,* 198 Fed. 199. See: *W. Va. and Ky. Ins. Agency* v. *Comm'r,* 18 B. T. A. 715 at page 723, where the Board of Tax Appeals so states.

It is scarcely conceivable that Congress, desiring to enact provisions that would not be "productive of constant litigation" and having in mind the decision in *Mutual Benefit Life Insurance Co.* v. *Herold, supra,* would have provided a deduction for "reserve funds required by law" with no other limiting provision if, in so doing, it had not intended to again provide a deduction for the reserve for supplementary contracts not involving life contingencies which, in that very case, was held ot be one of the "reserve funds" for which the earlier acts had provided a deduction.

The reserve deduction provision of the 1921 Act was reenacted without material change by the Revenue Acts of 1924, 1926, 1928 and 1932.[5] As already noted, the Regulations as issued under each of these Acts expressly held

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[4] *Notes on the Revenue Act of 1918, Part II, p. 33,* citing *Mutual Benefit Life Ins. Co.* v. *Herold* (1912) 198 Fed. 199; and *Northwestern Mutual Life Ins. Co.* v. *Fink* (1917) 248 Fed. 568.

The *Fink* case was subsequently reversed for failure of proof, 267 Fed. 968 at page 973 (CCA-7, 1920), but the Treasury Department recognized that this reversal was not contrary to the holding in *Mutual Benefit* v. *Herold, supra* and, accordingly, in Regulations issued seven months later, it was again expressly held that this reserve is one for which a deduction was provided by the 1918 Act: Regs. 45 (1920 ed.), Art. 569. And see Mills, *History of the Taxation of Life Insurance Companies Under the Federal Income, Capital Stock, and Excess Profits Taxes, 1909-1940, Temporary National Economic Committee Hearings,* Part 31-A, page 18099 at page 18113.

[5] Sec. 245(a)(2) of the Revenue Acts of 1924 (43 Stat. 289) and 1926 (44 Stat. 2nd Pt. 47); and Sec. 203(a)(2) of the Revenue Acts of 1928 45 Stat. 843), and 1932 (47 Stat. 224).

this reserve to be one of the "reserve funds" for which a deduction is provided by those Acts: *Reg. 62, 65, and 69, Art. 681; Reg. 74 and 77, Art. 971* (set out in Appendix).

Not until December, 1935, two years after the close of the taxable year involved herein, did the respondent, by a retroactive amendment of his regulations, attempt to exclude this reserve from the "reserve funds" for which a deduction is provided by the 1932 and prior Acts. *T. D. 4615, C. B. XIV-2, page 310.*

Under the circumstances, we respectfully submit that the decision below upholding the validity of this retroactive amendment of the Regulations, is in direct conflict with the decision of this Court in *Helvering* v. *R. J. Reynolds Tobacco Co., supra.*

II.

The decision below is in direct conflict with *Helvering* v. *Oregon Mutual Life Insurance Co.*, 311 U. S. 267.

The identical provisions of the Revenue Acts, the Regulations and administrative practice thereunder, and the retroactive amendment of those Regulations, which are involved in the instant case, were considered by this Court in *Helvering* v. *Oregon Mutual Life Insurance Co.*, 311 U. S. 267. There, holding this retroactive amendment of the Regulations invalid in so far as it attempted to exclude disability reserves from the "reserve funds" for which a deduction is provided by the 1932 Act, this Court said (311 U. S. 267 at pp. 270 and 272):

> "It is not disputed that administrative regulations promulgated under every Revenue Act from 1921 through 1932 recognized the right of life insurance companies to take deductions both for death and for disability reserves on policies such as those here involved. Nor is it denied that the 1934 reenact-

ment of section 203(a)(2) followed thirteen years of administrative regulation and practice under which substantially identical provisions had been so construed and applied that life insurance companies could and did obtain these deductions. During that entire period, the Treasury found no ambiguity in section 203(a)(2), and expressed no doubt as to a life insurance company's right to make such deductions. But on February 11, 1935, regulations were promulgated asserting disability reserves to be non-deductible under the 1934 Act; and on December 18, 1935, a Treasury Decision declared that this regulation applied retroactively to the 1932 and earlier Acts. Respondent now says that its former practice in permitting disability reserve deductions was erroneous, and that the new regulation should be given full retroactive effect.

* * * * * * * * *

We find it unnecessary to discuss the extent to which such a regulation might, under different circumstances, be given retroactive effect by virtue of the statutory power of the Commissioner. * * * For it is our conclusion that by section 203(a)(2) of the 1932 and 1934 Acts, Congress has granted life insurance companies a deduction for disability reserves which only Congress can take away."

What this Court there said with reference to deductions for disability reserves applies with equal force to the reserve deduction involved herein. See the dissenting opinion of Board Members Black and Arundell, below (R. 89).

In the *Oregon Mutual Life* case it was further held that (311 U. S. 267 at p. 270):

> "It seems clear that Congress intended to permit the deduction of reserves based on those policies that make a company a 'life insurance company' under the Act, which, by definition, includes policies of 'combined life, health, and accident insurance'."

This same statutory definition includes reserves held for the *fulfillment of annuity contracts* among the reserves which make a company a "life insurance company" under the Act. *47 Stat. 223, sec. 201(a).* And the reserve for "supplementary contracts not involving life contingencies" constitutes the major part of the *annuity reserves* held by life insurance companies doing business in this country.[6]

It has been held consistently that payments received by the beneficiaries under supplementary contracts not involving life contingencies constitute *annuities* within the meaning of that term as used in the revenue acts. It was so held in *Commissioner* v. *Winslow* (CCA-1, 1940), 113 F. (2d) 418. And see: *Old Colony Trust Co. et al.* v. *Commissioner*, 37 BTA 435, aff'd (CCA-1, 1939), 102 F. (2d) 380. The Bureau of Internal Revenue has so ruled consistently for nearly twenty years.[7]

The Commissioner's own definition of the term "annuities" as used in the revenue acts includes the supplementary contracts involved herein: *Reg. 103, Sec. 19.22 (b)(2)-2; Reg. 101, 94, 86, Art. 22(b)(2)-2;* (set out in Appendix). These regulations embody well established rulings of the Bureau issued under the earlier revenue acts. *S. O. 160, III-2 C.B., Dec. 1924, page 60; I. T. 2635, XI-2 C. B., Dec. 1932, page 63.*

The same fundamental reasoning which caused this Court in *Helvering* v. *Oregon Mutual Life Insurance Co., supra,* to hold that disability reserves are "reserve funds

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[6] *Spectator Compendium of Official Life Insurance Reports*, 1941, p. 136A where it is shown that payments made during 1940 by 305 life insurance companies under supplementary contracts totalled $213,400,837; and that all other annuity payments made that year by the same companies amounted to $142,284,323. While no split up is shown in the total amounts paid as between supplementary contracts involving life contingencies and supplementary contracts *not* involving life contingencies, the consideration received during the year for each of these types of contracts is shown, and indicates that 85% of the payments made under supplementary contracts were made under those which did *not* involve life contingencies.

[7] *S. O. 160, III-2 C. B., Dec. 1924, page 60; I. T. 2635, XI-2 C. B., Dec. 1932, page 63; I. T. 3033, XV-2 C. B., Dec. 1936, page 131; I. T. 3402, C. B. 1940-2, page 57; I. T. 3413, C. B. 1940-2, page 58; G. C. M. 21666, C. B. 1940-1, page 116; G. C. M. 22519, C. B. 1941-2, page 330.*

required by law" for which a deduction is provided by the 1932 Act, requires a like holding as to the reserve involved herein; and the decision below denying a deduction for this reserve is, therefore, in direct conflict with the decision of this Court in that case. See: *Mertens on the Law of Federal Income Taxation* (Callaghan & Co., 1942) Vol. 8, p. 154, *et seq.*

III.

The decision below is in direct conflict with decisions of other Circuit Courts of Appeals on the same matter.

The decision below, holding that the reserve for Supplementary Contracts Not Involving Life Contingencies is not a "reserve fund" for which a deduction is provided by the Revenue Acts, is in direct conflict with *Mutual Benefit Life Insurance Co.* v. *Herold* (1912), 198 Fed. 199 at pp. 213 and 214, aff'd with a *per curiam* opinion which did not mention this issue (CCA-3, 1913) 201 Fed. 918, cert. den. (1913) 231 U. S. 755.

On the alternative issue involving a deduction for excess interest paid by the petitioner on its supplementary contracts, the decision below is in conflict with the decision of the Circuit Court of Appeals for the Seventh Circuit in *Lafayette Life Insurance Co.* v. *Commissioner* (CCA-7, 1933), 67 F. (2d) 209. This conflict is noted by the court in its opinion below (R. 133).

On the same alternative issue the decision below, as noted by the court in its opinion (R. 132), is also in conflict with the decision of the Circuit Court of Appeals for the Third Circuit in *Lederer* v. *Penn Mutual Life Insurance Co.* (CCA-3, 1919) 258 Fed. 81 at p. 92, aff'd on other issues, 252 U. S. 523. In that case the question was squarely

presented whether the excess interest paid by a mutual life insurance company on its supplementary contracts, there called "Trust Certificates," constitutes interest or dividends. The undisputed testimony in that case shows that the payments there held to constitute not *dividends* but *interest* and therefore held to be deductible was excess interest over and above any guaranteed rate. See: p. 57 of the Transcript of the Record in *Penn Mutual Life Ins. Co.* v. *Lederer* (Oct. Term, 1919, No. 499), 252 U. S. 523.

IV.

In reaching its decision the court below misconstrued the opinions rendered in *Helvering* v. *Inter-Mountain Life Insurance Co.*, 294 U. S. 686, and *Helvering v. Illinois Life Insurance Co.*, 299 U. S. 88; and nothing said or held in those cases by this Court can properly be construed as barring a deduction for this reserve.

The court below felt compelled (R. 131) to reach its decision denying the reserve deduction involved herein because of certain remarks of Mr. Justice BUTLER in the opinions in *Helvering* v. *Inter-Mountain Life Insurance Co.*, 294 U. S. 686; and *Helvering* v. *Illinois Life Insurance Co.*, 299 U. S. 88.

But in neither of those cases was the reserve for "supplementary contracts not involving life contingencies" considered by this Court. In each of those cases the reserve deduction was claimed for a fund maintained for the profit of certain *policyholders*, a fund which was not held for *insurance obligations* contingent or otherwise. See *Helvering* v. *Oregon Mutual Life Insurance Co.*, 311 U. S. 267 at p. 271, where this Court said with reference to those decisions:

> "But those decisions rested upon the conclusion that the investment fund features had no relation to the insurance risks."

Neither of those decisions, therefore, bars a deduction for the reserve here involved, which is maintained solely for the protection of *insurance beneficiaries* in fulfillment of the *life insurance obligations* of the petitioner (R. 109, 118A and 120). See *1939 Supplement to Paul and Mertens on the Law of Federal Income Taxation, pages 1793 to 1796.*

The remarks of Mr. Justice BUTLER in the *Inter-Mountain* and *Illinois Life* opinions, with reference to reserve deductions for contingent liabilities, can properly be construed only in the light of the cases which gave rise to the "contingency" test or rule barring reserve deductions for most accrued or absolute liabilities. That rule or test was derived from cases decided under the 1918 and prior Acts which included premium receipts in the gross income of *all* insurance companies. *Mertens on the Law of Federal Income Taxation* (Callaghan & Co., 1942) vol. 2, §§ 44.28, 44.30 and 44.32.

The sole purpose of the reserve deduction under those earlier acts was to postpone the taxation of premium receipts until "earned": *Utah Home Fire Insurance Co.* v. *Commissioner*, 64 F. (2d) 763 (CCA-10, 1933), cert. den. 290 U. S. 679, 78 L. Ed. 586, 54 S. Ct. 103 (1933); *Commissioner* v. *Dallas Title & Guaranty Co.*, 119 F. (2d) 211 (CCA-5, 1941); *Union Underwriters of New York, et al.*, 4 BTA 472. And see: *Massachusetts Protective Assn., Inc.* v. *United States*, 114 F. (2d) 304 (CCA-1, 1940); *Travelers Equitable Insurance Co.*, 22 BTA 784. Quite obviously those acts provided a deduction only for *unearned* premium reserves. Accrued or absolute insurance liabilities which are *due and payable* do not constitute *unearned* premium reserves for such liabilities are always payable from *earned*

premiums. As a general rule, therefore, a deduction was provided by the 1918 and earlier acts only for reserves which represent contingent liabilities, and under those acts the "contingency" test or rule barring reserve deductions for most accrued or absolute liabilities was a valid aid in determining reserve deductions.

But one of the well recognized exceptions to the "contingency" test under the acts in force when that test was formulated, was the reserve for supplementary contracts not involving life contingencies. This reserve was expressly held both by the courts and by the regulations, to be one of the reserve funds for which a deduction was provided by the 1909, 1913, 1916, 1917 and 1918 Acts. (As shown under Point I, *ante*.) And this holding was proper because this reserve is held for benefits which are *not* yet due and payable (R. 120), and represents the unearned portion of the consideration received for the issuance of these contracts. See *Mertens on the Law of Federal Income Taxation* (Callaghan & Co., 1942) vol. 8, p. 162 and notes.

Under the 1921 and subsequent acts, including the Revenue Act of 1932, premium receipts are not included in the gross income of life insurance companies and the reserve deduction provided for such companies has nothing to do with "earned" or "unearned" premiums. Under the provisions of these later acts, therefore, it would seem that the reason for the rule barring reserve deductions for accrued or absolute liabilities of a life insurance company, no longer exists.

Quite aside from this fact, however, it is obvious that the remarks of Mr. Justice Butler in the *Inter-Mountain* and *Illinois Life* opinions, which appear to express approval of this test or rule, cannot properly be construed to bar a deduction under these later Acts for a reserve which was not considered by the Court in those cases and which was consistently and properly recognized as an

exception to the rule under the very Acts which were in force when the rule was formulated. *Mertens on the Law of Federal Income Taxation* (Callaghan & Co., 1942) §§ 44.32 and 44.34.

V.

The decision below, denying the reserve deduction involved herein, is contrary to the general legislative purpose of providing the reserve deduction and contrary to the specific legislative purpose of providing that deduction at a fixed statutory rate.

The general legislative purpose of providing the reserve deduction is to exempt from tax that part of a life insurance company's investment income which must be used to provide for the company's insurance obligations: *Finance Committee Report on the Revenue Bill of 1932*, S. Rept. No. 665, 72nd Cong. 1st Sess., at pp. 35 and 36; and see the dissenting opinion of Mr. Justice BRANDEIS in *National Life Insurance Co.* v. *United States*, 277 U. S. 508 at p. 525.

Supplementary Contracts Not Involving Life Contingencies are *life insurance obligations*. They constitute *annuities* provided for in practically all life insurance policies to effectuate what has been termed "the obvious purpose of life insurance," i. e., to afford protection to the beneficiary for a *period of years* subsequent to the death of the insured: Dawson, *The Business of Life Insurance* (1905), p. 241; Huebner, *Life Insurance* (1st ed.), pp. 99 and 100; Magee, *Life Insurance* (1939) pp. 325 to 327, and 464.

Just as the company is obligated prior to the death of policyholders to increase the reserve funds held for their policies at a specified rate from its gross investment income, so the company is obligated, after the death of the

policyholders, to add such increments of interest to the reserve funds held for the supplementary contracts arising out of those policies, and to pay the principal amount of such funds together with such increments of interest to the beneficiaries of such contracts in accordance with the terms thereof (R. 118, 120, 110). See Magee, *Life Insurance* (1939 ed.), pages 327, *et seq.*

In carrying out the general purpose of the Act, therefore, a deduction is just as necessary for this reserve as for any other life insurance or annuity reserve.

Furthermore, the specific legislative purpose of providing the reserve deduction at a fixed statutory rate rather than at the various rates *assumed* or *guaranteed* by different companies in calculating their reserves, requires the allowance for this reserve of the deduction provided by section 203(a)(2) of the 1932 Act for "reserve funds required by law."

In reporting the Revenue Bill of 1932 the Senate Finance Committee recommended that the reserve deduction be provided at the rates actually used by the different companies in calculating their reserves. This would have given a decided advantage to stock companies over mutual companies because the latter generally calculate their reserves at an *assumed* or *guaranteed* rate of 3% while stock companies, paying neither dividends nor excess interest, assume or guarantee a reserve earning of 3½% to 4%. *75 Cong. Rec. 11636 to 11647.*

It was to prevent such discrimination against mutual companies that the Senate rejected the Finance Committee's recommendation and Congress enacted the reserve deduction at a fixed rate as phrased by the LaFollette amendment. *75 Cong. Rec. 11636 to 11647.*

For a discussion of the LaFollette Amendment and of the reasons for its adoption, with particular reference to the reserve here involved, see: *Mertens on the Law of*

Federal Income Taxation (Callaghan & Co., 1942), Vol. 8, pp. 162 to 166, where it is stated (at p. 164):

> "To carry out this legislative purpose, it would seem just as necessary to allow a deduction at the fixed statutory rate for the reserve for supplementary contracts not involving life contingencies as for any other life insurance reserve. The issuance of supplementary contracts constitutes a large and increasing part of the business of life insurance. They are provided for in the policies of both mutual and stock companies and the guaranteed rates of interest upon which payments made under them are computed are generally the same rates assumed in calculating the policy reserves and premiums. To substitute for the reserve deduction, a deduction for interest paid on indebtedness in the amount of the guaranteed interest included in these payments would give the stock companies a decided advantage over the mutual companies at the expense of the policyholders of the latter which was just what Congress intended to prevent when it continued the reserve deduction at a fixed statutory rate in the Revenue Act of 1932."

Conclusion.

It is respectfully submitted that this is a case which this Court ought to review. It involves important questions of federal tax law. The decision below is in direct conflict with the decisions of this Court, in that it upholds the validity of a retroactive amendment of the Regulations which upsets twenty years of administrative regulations and practice by which the corresponding provision of every Revenue Act from 1913 to 1932 has been so construed and applied that life insurance companies could and did obtain deductions for this reserve. It is in direct conflict with *Helvering* v. *Oregon Mutual Life Insurance Co.*, 311 U. S. 267, at p. 270, where this Court held that:

"Congress intended to permit the deduction of reserves based on those policies that make a company a 'life insurance company' under the Act."

And on the alternative issues involving deductions for interest paid on indebtedness, the decision below is in conflict with the decisions of the Circuit Courts of Appeals for other Circuits which have passed on the questions.

Respectfully submitted,

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APPENDIX

Treasury Regulations
(As in force prior to December 18, 1935.)

Under the Revenue Act of 1913 (38 Stat. 172, 174), Article 147(d) of Regulations 33 provided:

> "(d) The reserve funds of insurance companies to be considered in computing the deductible net addition to reserve funds are held to include only the reinsurance reserve and *the reserve for supplementary contracts* in the case of life insurance companies, the unearned premium reserves in the case of fire, marine, accident, liability and other insurance companies, and only such other reserves as are specifically required by statutes of a State within which the Company making the return is doing business * * *." (Italics supplied.)

Under the Revenue Acts of 1916 (39 Stat. 768), and 1917 (40 Stat. 302), Article 240 of Regulations 33 (Revised) contained substantially the same wording as that quoted above from Regulations 33.

Under the Revenue Act of 1918 (40 Stat. 1079), Article 569 of Regulations 45 and 45 (1920 ed.), provided:

> "In the case of life insurance companies the net addition to the 'reinsurance reserve' and the *'reserve for supplementary contracts not involving life contingencies,'* and the net addition to any other reserve funds necessarily maintained for the purpose of liquidating policies at maturity, are legally deductible." (Italics supplied.)

Under the Revenue Acts of 1921 (42 Stat. 261), 1924 (43 Stat. 289) and 1926 (44 Stat. 2nd Pt. 47), Article 681 of Regulations 62, 65 and 69 provided:

> "Generally speaking, the following will be considered reserves as contemplated by the law: Items

> 7, 8, 9, 10 and 11 of the liability page of the annual statement for life companies, and items 16, 17, 18, 19 and 26 of the liability page of the annual statement for miscellaneous stock companies, if a life insurance company is also transacting other kinds of insurance business."

Under the Revenue Acts of 1928 (45 Stat. 843) and 1932 (47 Stat. 224), Article 971 of Regulations 74 and 77 provided:

> "Generally speaking, the following will be considered reserves as contemplated by the law: Items 7-11 of the liability page of the annual statement for life insurance companies, and items 16-19 and 26 of the liability page of the annual statement for miscellaneous stock companies, if a life insurance company is also transacting other kinds of insurance business."

From the liability page of the annual statements for life insurance companies, referred to in these Regulations, it will be noted that for the years 1913 to 1925 inclusive, Item 9, and for the years 1926 to 1934 inclusive, Item 10, read:

> "Present value of amounts not yet due on supplementary contracts *not* involving life contingencies."

See: *Bulletin "H," Income Tax Rulings Peculiar to Insurance Companies*, issued by the Treasury Department on April 9, 1921, at pages 7 and 27, where the liability page of the annual statements for life insurance companies is set out.

And see: *Pan-American Life Insurance Co.* v. *Commissioner* (1938) 38 B. T. A. 1430, at page 1437 and notes, aff'd (CCA-5, 1940), 111 F. (2d) 366, aff'd (1940) 311 U. S. 273.

TREASURY REGULATIONS DEFINING "ANNUITIES"

Article 22(b)(2)-2 of Regulations 86, 94 and 101; and Section 19.22(b)(2)-2 of Regulations 103; define the term "Annuities" as follows:

> "*Annuities*—Amounts received as an annuity under an annuity or an endowment contract include amounts received in periodical installments, whether annually, semiannually, quarterly, monthly, or otherwise, and *whether for a fixed period, such as a term of years,* or for an indefinite period, such as life, or for life, and a guaranteed fixed period, and which installments are payable or may be payable over a period longer than one year." (Italics supplied.)